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ON BEHALF OF THE NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY
BUSINESS OFFICERS

BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE
UNITED STATES CONGRESS
MAY 16, 2012

IN REGARD TO OPERATIONS AND OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS

Chairman Boustany, Ranking Member Lewis, and members of the Subcommittee, thank you for the opportunity to testify today on the oversight and operations of tax-exempt organizations. As Vice President for Finance and Chief Financial Officer at Cornell University, I am here to present the views of public and private nonprofit colleges and universities on behalf of the National Association of College and University Business Officers (NACUBO).

NACUBO, a nonprofit professional organization, represents more than 2,100 chief financial officers and nonprofit institutions of higher education and was established in 1962 to promote sound financial management in higher education. NACUBO, for 50 years, has been providing its members and others information and technical assistance in the field of higher education management and financial administration.

Cornell University is among the top research universities in the world, based on research expenditures, faculty quality, and reputation. It is located in Ithaca, N.Y., with campuses or programs in New York City, including Weill Cornell Medical College and Cornell NYCTech, home of the Technion-Cornell Innovation Institute; Geneva, N.Y.; Appledore Island, Maine; France; England; Italy; Singapore; India; China; Tanzania; Qatar and elsewhere, is the largest and most comprehensive school in the Ivy League and is the land-grant university of the State of New York. Founded in 1865, it is composed of 10 privately endowed and four state contract colleges, including seven undergraduate colleges and seven graduate and professional units. Our four contract colleges are units of the State University of New York (SUNY). Enrollment is approximately 20,000, with students from every state and more than 120 countries studying under an internationally renowned faculty. Forty Nobel Prize winners have been affiliated with Cornell University as alumni or faculty members, and three Nobel laureates currently are on the faculty, in chemistry and physics.

THE AUDIT EXPERIENCE

Cornell is a large research university with nearly \$3 billion in operating revenues and expenses during the last fiscal year. Cornell received the Internal Revenue Service (IRS) compliance survey for colleges and universities and completed and submitted the 33-page questionnaire in February 2009. In the fall of 2010, the IRS notified us that they would be auditing our Forms 990 and 990 T for the fiscal year that ended June 30, 2008. The initial conference with the IRS team also occurred in the fall of 2010. During the audit, our primary IRS contacts included the overall manager of higher education audits, two on site auditors, a computer specialist, and a valuation specialist. We closed the audit in March 2012.

The IRS audit of the University's Forms 990 and 990 T was in process for well over two years and absorbed significant staff time; each information request was complex and often required engagement by multiple staff members and documentation from numerous offices across the university.

The primary focus of the IRS audit was to ensure that all necessary information was comprehensively and completely reported on the 990. During the audit, Cornell provided CDs to the IRS computer audit specialist containing enormous data files with every transaction for the fiscal year under audit. The computer audit specialist worked with the staff of the University Controller and the IRS auditors to ensure that the 990 as filed was complete: the data were reconciled to our audited financial statements and our 990. The computer audit specialists also used these files to perform some additional data mining exercises.

The approach of requiring 100 percent of our transaction detail and using computer analysis and key questions and reconciliations was time consuming, but Cornell found it to be a strong and commendable audit step on the part of the IRS. In reviewing our 990, both parties were confident the audit examined the available universe of information.

Cornell also provided extensive documentation in response to at least 50 separate information documentation requests (IDRs). This included:

- Documentation in support of governance (e.g. board minutes and copies of formal policies regarding ethics, organization of subsidiaries).
- Documentation in support of compensation (e.g. board minutes, benchmarking studies and advisory information from outside consulting firms).
- Documentation in support of Unrelated Business Income (UBI) as reported on 990 T—including review of well over 100 K-1s from investments in Cornell's endowment that generate UBI and are reported on 990 T.
- A walk through campus and other document requests to evaluate whether there were other "business related activities not reported." The IRS concluded there were none.

The IRS undoubtedly has a better understanding of higher education after undertaking the Colleges and Universities Compliance Project. NACUBO expects that the responses to the

questionnaire, the subsequent audits of colleges and universities, and the final report from IRS will reflect that:

- Many colleges and universities have long had institutional policies and practices in place reflecting a commitment to stewardship, accountability and the highest standard of compliance with federal and state laws and regulations.
- Institutions of higher education are focused on teaching, research, and community service.
- Both private and public colleges and universities had well-established, sound and effective governing structures prior to IRS linking good governance with strong tax compliance and introducing governance-related questions to the Form 990.
- Although sometimes less visible to the public and to students and families, compliance with tax and other federal rules, regulations, and requirements by institutions is a part of the cost of a college education.

OVERSIGHT AND COMPLIANCE

Speaking on behalf of college and university business officers, our sector has markedly increased our internal efforts on tax compliance over the last 20 years. Beginning in the early 1990s, we began to see the appointment of campus tax directors at large research universities. Now it is not unusual for a large institution like Cornell to require a tax compliance department, with staff members trained to stay abreast of tax compliance requirements.

Cornell's approach throughout the 1990s was to ensure compliance with sufficient staffing and appropriate experience and on-going training. Cornell established a dedicated tax compliance office in 1993 and staffed that office with a Certified Public Accountant (CPA) who had over ten years' experience exclusively in tax administration and compliance. But as the requirements for reporting and compliance are ever changing and ever more complex, the University has also incurred additional costs and burden by engaging the services of an external auditor – a major CPA firm – to review and sign both the Form 990 and Form 990-T—though most of these Forms are “prepared” internally. The costs of engaging an external accounting firm is in addition to the costs of maintaining in-house expertise.

Cornell also seeks to be a voice within higher education to encourage the IRS to develop effective approaches to meet the needs of the Service, the public, and higher education in a reasonable and cost effective manner. We respond, most often as a member of a larger professional group like NACUBO, to the IRS' requests for responses to their proposals.

FORM 990

The IRS is requiring universities and other non-profit organizations to report more and more information. In addition to recent reforms that dramatically expanded the core form, exempt organizations are required to file 16 schedules to disclose a multitude of information about governance, financial information, compensation information, lobbying, fundraising, foreign operations, tax-exempt borrowing, and more. NACUBO submitted comprehensive comments on the 990 redesign in 2007, with the goal of working with the IRS to ensure that its efforts add value and increase understanding, rather than merely increasing administrative costs and creating confusion. With that objective in mind, I would like to raise a new concern with Form 990 regarding Schedule K-1.

In January of 2012, the IRS introduced a new requirement to report income, expenses, and balance sheet items related to partnership investments based on Schedule K-1 information. Historically, partnership information on the Form 990 was reported consistent with all other financial data based on an organization's books and records. Shifting to K-1-based reporting of partnership information will likely create a number of inconsistencies in Form 990 reporting of financial information. It most certainly will add substantial administrative burden for many colleges and universities, particularly institutions that receive a large number of Schedules K-1 related to partnership investments.

In response to comments and issues raised by the reporting community, this March the Service took a step back and announced that the requirement will not be mandatory, but optional for tax year 2011. We strongly encourage the IRS to eliminate the proposed requirement that income on the 990 be reported based on K-1s for the following reasons:

- The 990 is an information-based return based on our books and records.
- The K-1 is a tax-based reporting form.
- The K-1 information is already reported on the Form 990-T if that K-1 generates unrelated business income.
- The burden of reporting income on our 990 using a method separate and apart from our books and records is excessively burdensome.

CONCLUSION

As stewards of federal education, research, and student aid funding; as large employers; as significant operators of, in some cases, massive physical plant operations; and as home to our nation's college students, institutions of higher education take very seriously their approach to compliance with a host of federal rules and regulations, including those issued by the IRS. Ultimately, we hope the IRS uses all of the information it has garnered as part of the compliance project to continue to explore valuable and sensible approaches to streamlining reporting requirements.

Again, I thank you for calling this hearing. I would be pleased to answer any questions members of the Subcommittee may have.

Testimony Embargoed Until 5.16.2012 at 10am.